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Outline

• What is the historical context for NAFTA as a trade agreements?
• What did we expect to be the outcomes or benefits?
• What have been the general outcomes since NAFTA (and Uruguay Round)?
• How do we evaluate the success of a trade agreement?
• What if we terminated NAFTA?
• Where and how does Canadian Supply Management fit in?

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Bilateral and Multilateral Trade Agreements

Prior to WWII, trade agreements were typically between two countries – bilateral or a relationship of “commonwealth” countries.

Following WWII, multilateral trade agreements became a specific goal, for reasons of economics but also very much, even more so, for social or political security.

Two major agreements were 1) the various entities that finally culminated in the European Union and 2) the global General Agreement on Tariffs and Trade (GATT).

The last successful GATT negotiation (Uruguay) resulted in the WTO and a significant broadening of 1) market access, 2) elimination of quotas in favor of tariffs, and 3) concessions related to “trade distorting” domestic policies (cf. price and income supports in rich countries).

With the failure of the Doha Round, attention has reverted to smaller scale, “regional” agreements, generally referred to as a ”preferential trade agreement”. NAFTA is of this type.

PTAs are GATT/WTO legal if they eliminate trade barriers completely or move in that direction.
North America Free Trade Agreement - NAFTA

• Really 3 Separate Trade Agreements
  ➢ Canada – US Trade Agreement (CUSTA) effective in 1989
  ➢ Canada – Mexico Trade Agreement effective in 1993
  ➢ US – Mexico Trade Agreement effective in 1994
  ➢ NAFTA was considered a combined agreement in 1993

• n.b.

• Cell phones and Macintosh computer 1984, China Open Door Policy 1986-90, Chinese capitalism launched 1990s, Amazon 1994, Facebook 2004, iPhone 2007

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No doubt there were many challenges in putting together the set of agreements.

Between the US and Canada, dairy was both hard and easy. Hard in the sense it was sensitive for both countries. Easy once we agreed to leave each other alone.

Between the US and Mexico, cheap Mexican labor was the threat as well as the opportunity.
Mexican Trade Agreement

NAFTA provisions affecting the U.S.-Mexico trade in dairy products fall into three major categories: market access, sanitary and phytosanitary standards and rules of origin.

– Convert all trade barriers to tariffs (Mexico had extensive licensing of imports) and then reduce to zero over 5-15 years.

– Mexico gets a longer time to open markets
  
  Last part coming in 2008 (Mexico hoped to delay more)

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US exports to Mexico have expanded 28% per year from $1.1 billion in 1987 to $3.7 billion in 1992. The North American Free Trade Agreement (NAFTA), if implemented, will boost them further.

US dairy products have excellent potential in Mexico.

- US exports of all products totaled $160 million in 1992, growing at 30% per year.
- Opportunities are excellent for cheese, yogurt and ice cream. US faces tough competition on NDM.s
- NAFTA would eventually open the market much wider for all dairy products.
Gains from Trade – Mexico Style

Mexico has a rapidly growing population, and other provisions of the NAFTA are expected to have a positive impact on per capita income levels in Mexico in the long run. There is a tremendous demand for dry milk for beverage purposes in the two-thirds of Mexico's population that is poor and an export opportunity for Mexican style cheeses in the rest of the population. **On balance, NAFTA will be a plus for the U.S. dairy industry.**

*Mark Stephenson, 1993*
Gains from Trade – The MX Perspective

Using a sophisticated model of US and Mexican dairy markets and based on changes due to NAFTA and GATT:

Mexican producer prices are predicted to be as low as 50% of their 1992 levels, whereas retailer prices fall some 10 to 25%. Dairy processing in Mexico is predicted to increase under trade liberalization, due to the greater availability of dairy components.

As expected, trade liberalization is predicted to increase imports of milk powders previously subject to import controls, but imports of final products are less under NAFTA and GATT than under 1992 policies. Thus, Mexican dairy processing companies and consumers appear to benefit from dairy trade liberalization, but Mexican dairy producers will face additional competitive challenges in the future.

Charles Nicholson, 1994

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Gains from Trade Deniers/Realists

James Cranney (PSU), 1992: Tough on MX producers, good for MX consumers. “Substantial opportunities exist for U.S. exports of nonfat dry milk, butter and to a limited degree, fresh fluid milk. “ But, US will have to be prepared to match low international prices and use export subsidies.

William Dobson (UW), 1994: Mexico will have minimal affect on US dairy sector, with complications arising from difficult transportation, lack of US marketing acumen, tough foreign competition, and better options in the US.

Tom Cox et al. (UW), 1994: the more likely NAFTA and STATUS QUO scenarios generate very modest impacts on aggregate and regional U.S. dairy markets. This is mainly due to the fact that while the NAFTA may potentially generate large impacts on U.S.-Mexico dairy trade, these changes in U.S. exports are likely to remain a relatively small portion of U.S. total milk supply.
Outcomes: More to it than just dairy imports

• NAFTA, which came into force in January 1994, also represented a significant break with previous policies. Although it provides US dairy producers and companies with greater access to Mexican markets, it will also allow Mexican dairy producers (especially in the specialized system) to purchase imported inputs more cheaply. Thus, NAFTA will provide both incentives and disincentives to dairy production in Mexico.

• Charles Nicholson, 1994
WHAT HAS THIS MEANT FOR MILK PRODUCTION?
MX grew production more than the US, and CA barely at all.

Milk Production, Index 1990 = 100

- Canada
- Mexico
- United States

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A host of factors that go beyond who has the cheapest powder.

Competition unleashed by trade and investment liberalization under NAFTA will have the greatest impact on Mexico's dairy marketing subsector in the next decade.

Tariff reductions and liberalization of the trucking industry promise greater availability of imported dairy products in Mexico at lower prices.

Reform of investment regulations, and the strapped-for-capital condition of Mexico's dairy cooperatives, portend greater direct investment in dairy processing by foreign firms.

As domestic dairy companies continue to shake off the legacy of price controls, competition based on product quality will take on greater importance.

Post NAFTA, Mexico increased the "enforcement" of SPS regulations – "quality" as a barrier to trade.

Charles Nicholson, 1994

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Canadian Trade Agreement

Tariffs on most commodities phased out over 5-10 year period with following important exceptions being Tariff Rate Quotas (TRQ) on:

• Poultry: Canadian Poultry Board
• Dairy: Canadian Dairy Board and US price supports
• Sugar: US price supports

A TRQ allows a certain amount of imports at a lower tariff (sometimes zero) with impacts above the quota assessed a higher tariff.

• Example the TRQ in Canada for cheese is 245% of the price at 20,412 MT. For the US it is 58% at 134,995 MT.

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What Really Happened – Canada in particular cheese (cf. MPI controversy)


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Value of US Net Exports, 1980 to 2016

Value of US Net Exports, World, Canada, and Mexico,

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Has Trade Liberalization been a success?

By what criteria?

– Expansion of the economic pie
– Growth in low income countries
– Food security
– Inspired innovation and entrepreneurship
– Reduced international tensions

What needs improving?

– Alternatives for displaced workers
– Opportunities for those who seem to have no opportunities
Dairy trade protectionism begins to unravel, and then ravel back up again.

• Passage of WTO under Uruguay Round of GATT (1984-94) begins to seriously open dairy markets to new imports. US quickly increases imports and exports (from about 2% to 5% of market). Then exports take off in 2000+, led by powders. US is becoming a serious world trader.

• Doha Round (starting in 2001) hopes to expand on Uruguay, but becomes fatally stuck under protests by displaced laborers, environmentalists, and developing countries that want greater ag trade liberalization by US and EU and also less “trade distorting” domestic programs.

• Trump era ushers in a new protectionist instinct in hopes of rebuilding jobs from the old economy, as opposed to the new economy.

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US Dairy (Agriculture) Position and Concerns

Trade has been a success story for US agriculture and dairy – expanded economic pie
Not everybody feels like a winner but wins exceed gains
We very much value our trade (and other) relationships with Mexico and Canada
Although, we admit that Canada’s dairy policy is vexing (since we gave up our protectionist policy), and Mexican immigrants have pluses and minuses
US Dairy to Canada: You should step in, the water feels cold at first, then warms up
US Dairy to US Government: All in all, please don’t mess this up
The Federal Milk Marketing Order program may be unable to maintain significant class I prices and producer revenues if free trade in milk and dairy products becomes a reality in North America. Moreover, the adverse affects will be concentrated in specific regions. Both state and federal orders in these regions will be impacted.

As milk is diverted from these areas to fluid processing plants in Canada and Mexico, the disorderly conditions that federal orders sought to, and indeed did, alleviate may well begin to reappear.

Key to this conclusion is the requirement that Canada reform its own pricing system to exploit this potential. If they fail to do so, the tables could be turned.

Phil Bishop, 1997
Using the average net milk price at the farm for Quebec and New York in May 1995 and the predicted changes from the base simulation to the two trade scenarios, a price effect can be estimated.

In Quebec, dairy farmers received an average of $16.00 per cwt in May 1995. After simulation 1, milk price would have been reduced to $13.25 and further reduced to $12.25 with the implementation of free trade conditions.

New York dairy farmers received an average of $12.75 per cwt in May 1995. Simulation 1 results in a slight increase to $13.00 and, under free trade conditions, average price in New York for raw milk at the farm would rise to $14.50.

These price effects should be viewed as the first step in a price adjustment process following a shock to the market structure. The final equilibrium should imply a smaller price decrease for Quebec, and a smaller price increase for New York.

\[\text{Maurice Doyon, 1997}\]

- **1930 to 1941 to 1945**
  - We began using public funds to purchase surplus butter for food relief and school feeding programs
  - This ramped up during the War, with prices supported relative to input price inflation

- **1949**
  - Following post-WWII slump in exports and rise in costs, a Milk Price Support Program becomes permanent

- **1951**
  - Strict dairy import quotas are established with Secretarial authority to suspend them

- **1980s**
  - Excessive supports from late 1970s leads to massive surpluses in 1980s and meltdown of the MPSP

- **1995-96**
  - GATT Uruguay Round concluded. US dairy door is open for two-way traffic

- **2000-2001, 2002-2014**
  - Income subsidy created to supplement farm income when milk prices fall below a threshold (MILC)

- **2014-present**
  - Margin Protection Program for Dairy, based on milk price relative to feed costs, provides range of income subsidies where farmers pay “premiums” for higher coverage

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As in the US, Canada’s dairy industry was buffeted by the Great Depression and the economic tumult of WWII. This led to various interventions and initiatives intended to improve economic outcomes for dairy farmers, including the Agricultural Stabilization Board of the late 1950s.

In 1966, the Canadian Dairy Commission was created to "provide efficient producers of milk and cream with the opportunity to obtain a fair return for their labour and investment, and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality."

The National Milk Marketing Plan was inaugurated in 1970 with the cooperation of Quebec and Ontario and by 1974 it had the approval of all provinces save one (Newfoundland).
Both Systems have supported dairy farming but with very different outcomes.

The essence of the Canadian plan is to achieve better (higher) prices for farm milk by controlling the amount of milk available to buyers (supply).

This is in sharp contrast to the (historic) US approach, which was to create an alternative demand in the form of government purchases.

Both can be effective in raising prices beyond otherwise market clearing levels, but some differences include:

<table>
<thead>
<tr>
<th>Impact</th>
<th>Demand Control</th>
<th>Supply Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price logic</td>
<td>Keep prices from going too low</td>
<td>Move prices higher</td>
</tr>
<tr>
<td>Quantity Effect</td>
<td>Increases quantity</td>
<td>Decreases Quantity</td>
</tr>
<tr>
<td>Cost of Intervention</td>
<td>Costs are primarily in the form of higher prices but also include direct government costs of purchases</td>
<td>Cost are almost entirely in the form of higher prices to consumers, with modest administrative costs</td>
</tr>
<tr>
<td>Farm Effects</td>
<td>Reduced price risk may lead to over-investment</td>
<td>Marketing rights accrue rents and become a new costs. Cost based pricing reduces incentive to cost minimize</td>
</tr>
</tbody>
</table>
Factor Price Equalization

• The free trade simulation results suggest average world market farm prices near current U.S. levels,
• Farm milk prices in Western Europe, Japan, Canada, and South America are simulated to fall 17%, 53%, 24% and 10%, respectively.
• In contrast, Eastern Europe, Australian and New Zealand farm milk prices are simulated to rise 140%, 43% and 105%, respectively.

• "Cox and Zhu, 1997"
Yup, FPE happens – if you let it

Producer Prices for Milk, Selected Countries, 1990 to 2015, US$ per metric tonne

- Argentina
- Canada
- Germany
- Japan
- NZ
- USA

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Average Costs of Production in Canada and the US Northeast

Average COP as calculated by CDC for Canada and Farm Credit East for its NE customer/participants
Per hectoliter but native currency

Notable differences

- Costs of Capital and Physical Assets, including interest, depreciation, taxes, and insurance and Marketing costs: much higher CA
- Hired labor much higher US
- Cash costs are comparable
- Returns for family labor and capital built in for CA and high, for US they are what’s left over.

CA system all but eliminates income risk and builds in returns to family labor and capital. This tends to result in higher investments (lower capital productivity) and lower labor productivity

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2014-16</th>
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<tbody>
<tr>
<td></td>
<td>CA$/hL</td>
<td>US$/hL</td>
</tr>
<tr>
<td>Cash Costs</td>
<td>$45.50</td>
<td>$38.92</td>
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<tr>
<td>Purchased Feed</td>
<td>$16.75</td>
<td>$16.18</td>
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<tr>
<td>AI</td>
<td>$2.98</td>
<td>$1.93</td>
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<tr>
<td>Marketing</td>
<td>$5.26</td>
<td>$2.20</td>
</tr>
<tr>
<td>Land &amp; building repairs</td>
<td>$2.32</td>
<td>$4.30</td>
</tr>
<tr>
<td>Prop. Tax &amp; ins</td>
<td>$2.15</td>
<td>$0.66</td>
</tr>
<tr>
<td>Other</td>
<td>$16.04</td>
<td>$13.65</td>
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<tr>
<td>Capital Costs</td>
<td>$15.05</td>
<td>$4.04</td>
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<tr>
<td>Interest</td>
<td>$3.51</td>
<td>$0.78</td>
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<tr>
<td>Depreciation</td>
<td>$7.40</td>
<td>$3.26</td>
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<tr>
<td>ROE</td>
<td>$4.14</td>
<td></td>
</tr>
<tr>
<td>Labour Costs</td>
<td>$23.53</td>
<td>$7.43</td>
</tr>
<tr>
<td>Hired labor</td>
<td>$3.15</td>
<td>$7.43</td>
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<tr>
<td>Family labor</td>
<td>$15.04</td>
<td></td>
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<tr>
<td>Family mgmt</td>
<td>$5.34</td>
<td></td>
</tr>
<tr>
<td><strong>Total Cash Costs</strong></td>
<td><strong>$52.16</strong></td>
<td><strong>$47.13</strong></td>
</tr>
<tr>
<td><strong>Total Imputed Costs</strong></td>
<td><strong>$24.52</strong></td>
<td><strong>$3.73</strong></td>
</tr>
<tr>
<td><strong>Depreciation</strong></td>
<td><strong>$7.40</strong></td>
<td><strong>$3.26</strong></td>
</tr>
<tr>
<td>less non milk revenue</td>
<td>$(6.09)</td>
<td>$(8.22)</td>
</tr>
<tr>
<td><strong>Total COP</strong></td>
<td><strong>$78.00</strong></td>
<td><strong>$45.91</strong></td>
</tr>
</tbody>
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Quota Values are High and Increasing – A reflection of “rents” accruing from the quota system

Value of annual farm sales in Canada is about $7 billion

Value of quota is >$30 billion

Farmers initially received quota free of charge. However, quotas acquired market value, which has risen considerably over the years. For example, milk quota in Manitoba was selling for $27,399/kg in December 2015, compared to $12,000 in December 1998, an increase of over 100%. Across the country, the estimated total quota value was $32.6 billion in 2014, compared to $14.7 billion in 1998

... [for] a Quebec dairy farm with an average of 60 cows, quota alone represents an investment of $1.5 million...

Given the steep rise in milk quota prices and fears about excessive debt, the five provinces participating in the Agreement on Eastern Canadian Milk Pooling (Prince Edward Island, Nova Scotia, New Brunswick, Quebec and Ontario) established a quota pricing mechanism policy in December 2008. In 2010, Quebec and Ontario capped the quota price at $25,000 per kg

Khamla Heminthavong,
Economics, Resources and International Affairs Division, Library of Parliament,
17 December 2015
Canadian Evolution of Retail Dairy Prices

Indices of retail prices of selected dairy foods

- Whole Milk
- Lowfat Milk
- Butter
- Processed Cheese
- Canned Milk

1996 = 1
Indices of Retail Prices for Processed Cheese, Ground Beef and Chicken

Indices of Retail Prices for Butter & Cooking Oils
Indices of Retail Prices for Whole Milk and Colas

Comparison of National Average Prices for Whole Milk, $ per liter

- CA Whole Milk
- US Whole Milk
- US Whole Milk (CA$)

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Reforming Canadian Supply Management

• This was primarily an internal question until the recent MPC trade and Class 7 pricing issue.
• CA exports of Class 7 products was a strategic error. CA will lose an ultimate WTO adjudication, as it did in ca. 2000
• US dairy leaders apparently see opportunity to attack the system. Unleashes CA reactions based on sovereignty, not economics
• Elimination of quotas would transform CA’s dairy farm sector in much the same was as the US has evolved
• Eventually trade would be two-way and shift, to an extent, from latitudinal to longitudinal

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